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No. 85-1385

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

GENERAL DYNAMICS CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

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1. We contend in our petition that the decision below conflicts with the decisions of other circuits concerning the proper time for accruing tax deductions. See, *e.g.*, *Bennett Paper Corp.* v. *Commissioner*, 699 F.2d 450 (8th Cir. 1983); *Trinity Construction Co.* v. *United States*, 424 F.2d 302 (5th Cir. 1970). The employer in these cases had a contractual obligation to pay future benefits to or for its employees. Although the employer's liability was in large part determined by the workers' past performance of services, its obligation to make the payments at issue was nevertheless contingent at the close of the tax year because it was conditioned on a future event, such as the employees' being alive, or still being employed, at the relevant future time. The courts in these cases denied the employer a current tax deduction, reasoning that an expense is deductible "only in the taxable year when the obligation to pay it is unconditionally fixed" (*Trinity Construction Co.*, 424 F.2d at 305),

and that a "liability is not fixed until all the conditions for payment are met" (*Bennett Paper Corp.*, 699 F.2d at 453). Although these cases did not involve employer obligations under medical expense reimbursement plans, we argued that they involved "circumstances substantially similar to those here" (Pet. 18) and hence conflicted with the decision below.

Respondent does not seek to distinguish these cases on the ground that they involved different sorts of employer-provided benefits. Respondent tries to distinguish them, rather, on the ground that, "[i]n each of these cases, a future event had to happen before any underlying liability came into existence" (Br. in Opp. 11). Respondent argues that its liability to reimburse its workers was not contingent on any future event, but rather became fixed and unconditional "[o]nce the employee had been to the doctor and received the medical services" (*ibid.*).

Respondent's attempted distinction is based on its assumption that the decision below was correctly decided, an assumption with which we of course disagree. Unlike the court of appeals, we think that respondent's year-end liability *was* contingent on future events, namely, upon (1) an employee's submission of a properly-documented claim for reimbursement and (2) respondent's determination that the claim qualified for payment under the terms of the health plans. As we have argued in *United States* v. *Hughes Properties, Inc.*, No. 85-554, the kind of liability presupposed by the "all events" test is the obligation *to make a payment*. See 85-554 U.S. Br. 13-16; 85-554 Reply Br. 3-5.[1] Respondent's obligation to make a payment to its employees was not unconditionally established by the fact that some of them may have visited a doctor before the close of the tax year—a

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[1]We are supplying respondent's counsel with copies of these briefs.

fact which, as we have emphasized (Pet. 12), respondent assumed and estimated rather than proved. To the contrary, respondent's obligation to pay reimbursement did not arise until those employees who had visited a doctor subsequently (1) filed properly-documented claims for reimbursement and (2) satisfied respondent that the medical services that they had received from the doctor were in fact "covered medical services" qualifying for payment under the plans. It is of course true that an employee's visit to a doctor was a *necessary* condition to his eventual receipt of reimbursement, just as an employee's past performance of services in *Bennett Paper Corp.* was a necessary condition to his eventual receipt of the profit-sharing benefits there involved. An employee's visit to the doctor, however, was not a *sufficient* condition to fix respondent's liability, but was only the first in a series of events — an often time-consuming series — by which uncontestably allowable claims were winnowed from an undifferentiated mass of actual and potential requests for reimbursement. Here, as in *Bennett Paper Corp.* and *Trinity Construction Co.*, further events had to occur after the close of the tax year in order for the employer's inchoate liability under its contract to ripen into the concrete obligation to pay something to someone.

As respondent points out (Br. in Opp. 6-7, 14-15, 17-18, 21), of course, the future events that were required to fix its obligation to make a payment had a fairly good chance of occurring. It was likely that many of respondent's employees who had visited a doctor during 1972 would subsequently file claims for reimbursement. And there was a probability — apparently in the range of 90% (Pet. App. 12a) — that those claims, if filed, would be determined to qualify for some payment. But these facts in no way distinguish this case from the cases with which we believe it conflicts. In *Bennett Paper Corp.*, for example, the employer similarly argued that "the Commissioner should

not have considered the accrued [profit-sharing] contribution contingent" inasmuch as there was only a "*de minimis*" possibility that workers would forfeit their benefits by premature termination from service (699 F.2d at 453). The employer in fact demonstrated that, "[o]ver a five-year period, forfeitures amounted to two-tenths of one percent of the contributions to the plan" (*ibid.*). But the Eighth Circuit rejected the employer's argument, holding that its "liability [was] not fixed until all the conditions for payment were met, including the employee remaining an employee" until the relevant future time (*ibid.*). The court of appeals below, in holding that a substantial probability of incurring a liability to make a payment suffices to justify a deduction under the all events test, went into conflict with these decisions and with the decisions of this Court.

2. Respondent disputes our contention (Pet. 18-20) about the importance of this case, asserting that the Federal Circuit's decision was narrowly confined to its facts and that "[i]t is just too soon to tell whether this case will have any broad impact" (Br. in Opp. 12). Other spokesmen for the business community, however, have taken a rather different view of the decision below. A recent issue of *Forbes* magazine described that decision as a "light on the horizon" illuminating the prospect that corporations at long last may be able to deduct "[p]ayments made to self-insurance reserves" (Saunders, *Light on the Horizon,* Forbes, Mar. 24, 1986, at 120). The article noted that "[t]he IRS zealously pursues anyone who tries to blur the distinction between insurance companies and noninsurance companies" and that the Commissioner had accordingly denied respondent's "right to deduct $5.6 million for a self-insurance reserve for 1972" (*ibid.*). The article noted that respondent in 1972 had "pulled some medical coverage from Aetna and Prudential," had "used the insurers' own methods to calculate what the proper reserve would be," and had "contributed that

amount into a self-insurance reserve, deducting the contribution" as a current expense (*ibid.*). The article noted that Congress in 1954 had briefly enacted a provision[2] that would have "allowed noninsurance companies to deduct self-insurance payments," that this provision was projected to "cost the Treasury nearly $1 billion — $4 billion in today's dollars," and that "[l]awmakers hurried to repeal the legislation retroactively" the very next year (*ibid.*). "Small wonder," the article concluded, "that 'devastating' is what [an IRS spokesman] calls the possibility that the Supreme Court might act to uphold the lower courts or passively do so by refusing to hear the case" (*ibid.*). In view of the nationwide jurisdiction of the Court of Appeals for the Federal Circuit, this assessment by a well-known magazine emphatically corroborates our submission concerning the importance of this case.

3. Respondent devotes the bulk of its brief (Br. in Opp. 13-21) to an elaboration of its contention that the decision below was correctly decided. We think that these contentions are best debated in briefs on the merits.

For these reasons and those set forth in our petition, it is therefore respectfully submitted that the petition for a writ of certiorari should be granted.

CHARLES FRIED
Solicitor General

APRIL 1986

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[2]26 U.S.C. (1952 ed. & Supp. II 1954) 462 (discussed at Pet. 16-17).